

NOTE: Revisions to the 12/7/99 OUTLINE are underscored.

OUTLINE
Act 70, SLH 1999 AND ACT 198, SLH 2000
GET Exemption for Exported Contracting or Services; and
Use Taxation of Imported Contracting or Services
Prepared by DOTAX, State of Hawaii

I. OLD LAW

- A. Contracting. The GET at the rate of 4% applies to the gross income received from contracting where the real property to which the contracting relates is located in Hawaii. The GET does not apply to gross income received from contracting where the real property to which the contracting relates is located outside Hawaii, notwithstanding incidental expenses in Hawaii. (See Tax Information Release (TIR) No. 98-9, November 6, 1998)
- B. Services. The GET at the rate of 4% applies to the gross income received from the sale of a service where the "place of performance" is wholly within Hawaii. The "place of performance" is the state or place where services are performed. (See TIR No. 98-9)
- C. Exported tangible personal property and computer services. The gross income received from the sale of tangible personal property (HRS § 237-29.5) or services performed in the production and sale of computer software which is shipped out of Hawaii for resale, consumption or use outside Hawaii is exempt from the GET. (The GET exemption for certain computer services in HRS § 237-29.6 was repealed by Act 70, but the exemption is encompassed in Act 70's GET exported services exemption. See HRS § 237-29.53)

II. GET EXEMPTION FOR EXPORTED CONTRACTING OR SERVICES

- This exemption is intended to: (1) level the playing field for those Hawaii contractors and service businesses who must compete for out-of-state business with out-of-state contractors and service businesses not subject to the GET; and (2) provide parity of tax treatment between exported contracting and services, (subject to the GET under current law), and exported tangible personal property (exempt from the GET under current law).
- A. The exemption applies to the following activities:
 - 1. "Contracting" means a person taxable under HRS § 237-13(3) or 237-16 and defined in HRS § 237-6.¹

¹ Contracting includes: (1) Every person engaged in the business of contracting to erect, construct, repair, or improve buildings or structures, of any kind or description, including any portion thereof, or to make any installation therein, or to make, construct, repair, or improve any highway, road, street, sidewalk, ditch, excavation, fill, bridge, shaft, well, culvert, sewer, water system, drainage system, dredging or harbor improvement project, electric or steam rail, lighting or power system, transmission line, tower, dock, wharf, or other improvements;

(2) Every person engaged in the practice of architecture, professional engineering, land surveying, and landscape architecture, as defined in HRS § 464-1; and

(3) Every person engaged in the practice of pest control or fumigation as a pest control operator as defined in HRS § 460J-1.

2. A “service business or calling.”²
- B. Two Separate Exemptions.
 1. “Unbundled transactions.” The exemption applies to a person engaged in contracting or a service business or calling:
 - a. Who performs contracting or services (including professional services) in Hawaii;
 - (1) A person classified as a representative or purchasing agent under HRS § 237-1 performing services for another in which commission income is subject to the GET under HRS § 237-13(5), is not engaged in a service business or calling under Act 70.
Ex (1): An investment adviser receiving commission income for providing securities or mutual fund investment advice to customers in Japan is not engaged in a service business or calling.
 - b. The contracting or services are for resale, consumption, or use outside of Hawaii;³
 - (1) For contracting, use is where the construction project is located.
Ex (2): Hawaii architect performing design work in Hawaii for a Hong Kong hotel qualifies. (The hotel project is located in Hong Kong.)
Ex (3): Hawaii architect designing a Guam hotel for a Guam subsidiary of a Hawaii hotel chain that has its headquarters in Hawaii qualifies. (The hotel project is located in Guam.)
Ex (4): Hawaii architect designing a Maui building for a mainland developer does not qualify. (The building project is located in Hawaii.)
 - (2) Whether the services are for use outside of Hawaii is determined upon all of the facts and circumstances, including the customer’s physical location or residence in the case of individuals receiving the services, or the place of incorporation, commercial domicile, or the location of the subsidiary or branch in the case of businesses receiving the services.
Ex (5): Hawaii marketing consulting company developing a Japan marketing program for a Guam branch of a Hawaii hotel chain that has its headquarters in Hawaii qualifies. (The customer is the Guam branch.)
Ex (6): Hawaii company performing services in Hawaii for an office of the U.S. Department of Defense located in Washington, D.C. qualifies even though the Department of Defense has offices located in Hawaii. (The customer is the Washington D.C. office.)
Ex (7): Hawaii company receiving a fee for providing tour guides to a Hawaii hostel program’s group traveling to the South Pacific does not qualify. (The customer is located in Hawaii (Hawaii elder hostel), but fee may be subject to apportionment.)

² §§ 237-29.53(c) and 238-1 of Act 70 define a “service business or calling” to include professional services, but does not include the services rendered by an employee to the employee’s employer.

³ Act 198 deleted the requirement that the contracting or services be performed “for a customer located outside the State.”

- (3) Work performed in Hawaii is not resold, consumed, or used outside of Hawaii when the work is performed to protect the customer's legal, contractual, or financial interest in Hawaii.

Ex (8): Hawaii CPA performing financial analysis for a mainland client for an investment in a Hawaii company qualifies. (The analysis is used by the client outside of Hawaii to decide whether to invest in the Hawaii company. In contrast, the CPA's financial analysis services do not qualify for the export exemption if the mainland client is continuing an existing investment in the Hawaii company.)

Ex (9): Hawaii company performing debt collection and motor vehicle repossession services in Hawaii at the request of a mainland financial institution does not qualify. (The services are performed to protect the financial institution's Hawaii legal interests.)

Ex (10): Hawaii accountant preparing Hawaii income tax return for a nonresident individual does not qualify. (The nonresident individual has a Hawaii obligation to file a return; compare this to Ex (8) where the CPA is performing a financial analysis for the mainland client.)

Ex (11): Hawaii accountant preparing a federal tax return for a foreign corporation qualifies. (The federal return is filed outside of Hawaii.)

Ex (12): Hawaii accountant preparing Hawaii tax returns for mainland company's Hawaii store does not qualify. (The mainland company has an obligation to file the Hawaii tax returns.)

Ex (13): Hawaii attorney litigating case in Hawaii for a mainland client does not qualify. (Hawaii attorney is performing services to protect mainland client's Hawaii legal interests.)

Ex (14): Hawaii attorney preparing and filing Hawaii limited liability company documents with the Department of Commerce and Consumer Affairs for mainland client does not qualify. (Hawaii attorney is performing services to protect mainland client's Hawaii legal interests.)

Ex (15): Hawaii company receiving a fee (not commission income) for making arrangements and providing tour guides to a mainland elder hostel program's group traveling to the South Pacific qualifies. (The customer is the mainland elder hostel and services are performed outside of Hawaii; compare to Ex (7) where Hawaii elder hostel is the customer.)

Ex (16): Hawaii employment agency receiving a fee from a Hawaii resident for employment placement with a mainland company does not qualify. (The agency has a contractual interest in Hawaii with the placement of the Hawaii resident.)

Ex (17): Hawaii doctor providing medical services to a Japanese visitor does not qualify. (The medical services are consumed in Hawaii.)

Ex (18): Heart specialist providing advice to a doctor in Guam via a telemedicine network qualifies. (The services are for use or consumption outside of Hawaii.)

- c. Would otherwise be subject to the GET at 4% on the gross income; and

- d. Obtains a certificate from the customer located outside of Hawaii certifying that contracting or services will be resold, used, or consumed outside of Hawaii. (Form G-61)
- 2. "Bundled Transactions." The exemption applies to a person engaged in contracting or a service business or calling:
 - a. Who performs contracting or services (including professional services) in Hawaii:
 - For a "purchaser" who is engaged in business in Hawaii who:
 - (1) Resells all of the contracting or services for resale, consumption, or use outside of Hawaii;
 - (2) Would otherwise be subject to the GET at 4% on the gross income; and
 - (3) Obtains a certificate from the customer certifying that contracting or services will be resold, used, or consumed outside of Hawaii (Form G-61);
 - b. The person performing the contracting or services obtains a certificate from the "purchaser" certifying that contracting or services are for resale, use or consumption outside of Hawaii (Form G-61); and
 - c. The "purchaser" qualifies for the general excise tax exemption under II.B.1 above.
 - Ex (19):** Hawaii architect (purchaser) performing design work in Hawaii for Hong Kong hotel hires a Hawaii engineering firm to provide engineering services for the hotel project. Both Hawaii engineering firm and architect qualify for the GET export exemption as a "bundled transaction." Hawaii architect is not eligible for the subcontract deduction for amounts paid to the Hawaii engineer because the GET export exemption applies; the subcontract deduction otherwise requires the subcontractor's income to be subject to the GET.
 - Ex (20):** Hawaii interior designer performing services for Hawaii contractor who is renovating a hotel located outside of Hawaii qualifies. (The services of the Hawaii interior designer are for resale outside of Hawaii.)

III. USE TAXATION OF IMPORTED CONTRACTING OR SERVICES

- The imposition of the use tax on imported contracting or services is intended to: (1) level the playing field for those Hawaii contracting or service businesses subject to the GET performing work for Hawaii customers (out-of State contracting or service businesses are not subject to the GET); and (2) provide parity of tax treatment between imported goods (subject to the use tax under current law) and contracting or services.
- Act 198 imposes the use tax on contracting, as defined in section 237-6, HRS, which is imported into Hawaii for resale or use. But see the exclusion for a construction industry contractor in section III. A. 4. of this outline. Act 70 imposed the use tax on services, but not contracting; there is a distinction between the two activities for the GET. The imposition of the use tax on imported contracting will complement the GET exemption for exported contracting.

- A. The use tax is imposed on the “value” of contracting or services that are performed by an unlicensed seller at a point outside of Hawaii and imported or purchased for use in Hawaii. “Value” means the fair and reasonable cash value at the time of accrual of the use tax.⁴
 1. Analogous to the use taxation of tangible personal property. The tax is imposed at different rates (0%, ½%, or 4%) on the importer or purchaser depending upon how the importer or purchaser “uses” (e.g., resells, consumes, etc.) the imported contracting or service.
 2. “Use” means any use, whether the use is of such nature as to cause the property, contracting, or services to be appreciably consumed or not, or the keeping of the property, contracting, or services for such use or for sale, and shall include the exercise of any right or power over tangible or intangible personal property incident to the ownership of that property.⁵
 3. “Use” does not include services or contracting imported for resale, consumption, or use outside Hawaii. This use tax exemption is similar to the GET exemption for “bundled” contracting or services discussed in II.B.2. above on page 4 of this outline..
 4. “Use does not include the use of contracting imported or purchased by a contractor defined in section 237-6, HRS, who is:
 - (a) Licensed under the GET;
 - (b) Engaged in business as a contractor; and
 - (c) Subject to the use tax on imported contracting. See HRS § 238-1(10), which was added by Act 198.

This use tax exclusion applies to imported contracting when the same contracting performed by a local contractor or specialty contractor would have qualified for the GET subcontractor deduction. This avoids discrimination against imported contracting.

Ex (21): A Hawaii contractor engages a mainland engineer to perform contracting work for a project in Hawaii. The engineer does not perform any work in Hawaii. The Hawaii contractor has imported contracting but is exempt from the use tax because a local engineer performing the analysis would qualify for the GET subcontract deduction.⁶

Ex (22): A Hawaii home owner engages a mainland architect to draw plans for a new home; the architect does not perform any work in Hawaii and pays no GET on the gross income received for drawing the plans. The home owner is subject to the use tax at the rate of 4% on the value of the imported plans because the mainland architect’s work would not qualify for the GET subcontract deduction.
 5. The use taxation of imported contracting or services incorporates the same “identifiable element” and “overhead” tests in Act 71, SLH 1999.
- B. Determining the use tax rate.
 1. Imported services that qualify for the **0%** use tax rate:
 - a. The imported services are combined with another service performed in Hawaii.
 - (1) The importer or purchaser is:
 - (A) Licensed under HRS chapter 237, and

⁴ HRS § 238-1.

⁵ HRS § 238-1, as amended by Act 70, SLH 1999

⁶ Derived from Lorman problem #3.

- (B) Engaged in a service business or calling;
- (2) The imported services become an “identifiable element” of the services the importer or purchaser renders for another person;
- (3) The importer or purchaser is subject to the GET rate of ½% or the rate imposed under section 237-13.3, HRS, on the gross income it receives for rendering the service;⁷ and
- (4) The imported services are not “overhead” to the importer or purchaser.

Ex (23): Hawaii consulting firm (TP) is contracted by a Hawaii investment company to perform a feasibility study regarding the purchase of California property for the investment company’s Hawaii client. TP hires a California company to perform the feasibility study. TP submits completed study to the Hawaii investment company without performing further work. TP is not subject to the use tax on the value of the imported services performed by the California consulting firm, but is subject to the GET at the intermediary services rate of ½%. The Hawaii investment company is subject to the GET rate of 4%.

Ex (24): Hawaii developer engaging a mainland interior designer who comes to Hawaii to furnish model homes for a Hawaii housing development is not importing services. (The interior designer is performing services in Hawaii and is subject to the GET. The Hawaii developer may not take a subcontract deduction for the services performed by the interior designer, whose services are not classified as contracting under the GET.)⁸

b. Imported services are combined with a finished or saleable product.

- (1) The importer is:
 - (A) Licensed under HRS chapter 237, and
 - (B) A manufacturer as described in HRS § 237-13(1)(A);
- (2) The imported services become an “identifiable element” of the finished or saleable product (including the container or package in which the product is contained);
- (3) The product is to be sold at wholesale (subject to the GET rate of ½%) by the manufacturer; and
- (4) The imported services are not “overhead” to the manufacturer.

Ex (25): Hawaii software company (TP) contracts a Japanese software company to develop part of the software to be incorporated into a computer game compact disc (CD). The CDS will be manufactured by TP and sold at wholesale to Hawaii retailers. TP is not subject to the use tax on the imported services of the Japanese software company, but is subject to the GET rate of ½% on the CD sales to Hawaii retailers.

⁷ Act 198 amended the law to allow the 0% use tax rate on imported services for transactions qualifying for phased-in GET pyramiding relief under Act 71, SLH 1999. These transactions are analogous to wholesale transactions qualifying for the 0% use tax rate. Prior to this amendment in Act 198, imported services that qualify for the phased-in GET pyramiding relief were subject to the 4% use tax rate.

⁸ Compare example 30 on supermarket chain on page 8, in which the interior designer does not perform services in Hawaii.

2. Imported services that qualify for the ½% use tax rate:
 - a. The imported services are combined with another service performed in Hawaii.
 - (1) The importer or purchaser is:
 - (A) Licensed under HRS chapter 237, and
 - (B) Engaged in a service business or calling;
 - (2) The imported services become an “identifiable element” of the service the importer renders to another person;
 - (3) The importer or purchaser is subject to the GET rate of 4% on the gross income it receives for rendering services; and
 - (4) The imported services are not “overhead” to the importer or purchaser.
Ex (26): Hawaii attorney is hired by a client in a medical malpractice lawsuit. The attorney hires a California doctor to review medical reports and hospital records that will be used during the litigation. Hawaii attorney is subject to the use tax rate of ½% on the value of the imported services of the California doctor and 4% GET on the gross income received from the client.
 - b. The imported services are combined with a finished or saleable product.
 - (1) The importer is:
 - (A) Licensed under HRS chapter 237, and
 - (B) A manufacturer as described in HRS § 237-13(1)(A);
 - (2) The imported services become an “identifiable element” of the finished or saleable product (including the container or package in which the product is contained);
 - (3) Product is to be sold at retail (4% GET) by the manufacturer; and
 - (4) The imported services are not “overhead” to the manufacturer.
Ex (27): Hawaii manufacturer hires a mainland graphics designer to develop a design to be printed on a shirt that is sold at retail by the manufacturer. Hawaii manufacturer is subject to the use tax rate of ½% on the value of the imported design used on the shirts and the GET rate of 4% on the retail sale of the shirts.
 - c. The imported services are combined with a finished work or project.
 - (1) The importer is:
 - (A) Licensed under HRS chapter 237, and
 - (B) A contractor as defined in HRS § 237-6;
 - (2) The imported services become an “identifiable element” of the finished work or project required under the contract;
 - (3) The contractor is subject to the GET under HRS § 237-13(3) or 237-16 on the gross income derived from the contract; and
 - (4) The imported services are not “overhead” to the contractor.
Ex (28): Hawaii architect designing an office building in Hawaii engages an Oregon company to conduct tests in Oregon on building material. The architect is subject to the use tax rate of ½% on the value of the imported testing services.
Ex (29): Hawaii contractor uses a California draftsman to draw house plans for contractor’s clients. The contractor charges the client for the plans and is subject to the GET rate of 4%. The contractor is subject to the use tax rate of ½% on the value of the imported house plans (imported services.)

Note: The Hawaii contractor may not take a GET subcontract deduction for the work performed by the California draftsman because the draftsman has not performed work in Hawaii that is subject to the GET.⁹

3. Imported services that are subject to the 4% use tax rate:

- a. In all other cases which do not qualify for the 0% or ½% tax rate.
- b. All services imported for consumption by the importer, including “overhead.”

Ex (30): A national supermarket chain with stores in Hawaii remodels the stores, using specifications developed by a mainland interior designer (who did not perform any work in Hawaii). The supermarket chain is subject to the use tax rate of 4% on the value of the imported services (specifications) used to remodel the Hawaii stores.

Ex (31): Custom software (software made to customer’s specifications) purchased and downloaded from the Internet for use or consumption by the purchaser is treated as imported services that is subject to the use tax rate of 4%. (Canned software purchased and downloaded from the Internet for use or consumption by the purchaser is treated as imported tangible personal property that is subject to the use tax rate of 4%.)

Ex (32): A Hawaii financial institution outsourcing its credit card administration and collection services to a mainland company is subject to the use tax rate of 4%.

Ex (33): Legal services performed by a mainland parent corporation for a wholly-owned Hawaii subsidiary are exempt from the use tax because of the related entity exemption in HRS § 237-23.5. The director of taxation is authorized to exclude the imposition of the use tax to avoid discrimination against imports. See section IV.)

IV. DIRECTOR’S AUTHORITY TO EXEMPT, EXCLUDE, OR APPORTION USE TAX (Act 198)

A. To the extent that any exemption, exclusion, or apportionment is necessary to conform the imposition of the use tax on imported services or contracting to the Constitution or laws of the United States, the director of taxation shall:

1. Exempt or exclude the imposition of use tax on property, services, or contracting exempt from the GET; or
2. Apportion the gross value of services or contracting sold to customers within Hawaii by persons engaged in business both within and without Hawaii to determine the value of the portion of the services or contracting that is subject to the GET under HRS § 237-21.

Ex (34): Hawaii contractor buys a used backhoe from a mainland contractor for use in Hawaii. The Hawaii contractor is exempt from the use tax because the purchase of a backhoe from a Hawaii contractor would qualify as a casual sale that is exempt from the GET. The director of taxation is authorized to exclude the imposition of the use tax to avoid discrimination against imports.

⁹ Under Act 70, the use tax is not imposed on imported contracting (as defined in HRS § 237-6). The use tax is imposed on the “value” of services that are performed by an unlicensed seller at a point outside Hawaii and imported or purchased for use in Hawaii.

Ex (35): Administrative services, including bookkeeping and personnel services performed by the mainland headquarters of a financial institution for their Hawaii branch are not subject to the use tax rate of 4%. (If the administrative services instead were performed by the Hawaii branch, the GET would not be imposed on these services. The director of taxation is authorized to exclude the imposition of the use tax to avoid discrimination against imports. But compare Ex (32) where outsourced services imported for use in Hawaii are subject to the use tax.)

Ex (36): A Hawaii business engages an accounting firm to obtain a tax ruling from the Internal Revenue Service. 60% of the work is performed by the firm's Washington D.C. office and 40% is performed by the firm's Hawaii office. While the Hawaii office is subject to the ½% use tax on the work performed by the Washington D.C. office (60% of the work), the director of taxation is authorized to exclude the imposition of the use tax to avoid discrimination against imports. If the firm's Hawaii office performed 100% of the work in Hawaii, no use tax or GET at the ½% rate would have been imposed.

V. DEFINED TERMS¹⁰

- A. "Overhead" is defined as the continuous or general costs occurring in the normal course of a business, including but not limited to costs for labor, rent, taxes, royalties, interest, discounts paid, insurance, lighting, heating, cooling, accounting, legal fees, equipment and facilities, telephone systems, depreciation, and amortization.
- B. "Unlicensed seller" is defined in HRS § 238-1 as any seller who, with respect to the particular sale, is not subject to the tax imposed by chapter 237, whether or not the seller holds a license under that chapter, but does not include any seller with respect to any sale which is expressly exempted from the tax imposed by chapter 237.

VI. EFFECTIVE DATES

- A. GET provisions apply to gross receipts received beginning January 1, 2000.
 - HRS §237-3 relating to cash and accrual accounting methods applies.
- B. Use tax provisions apply to taxes accruing beginning January 1, 2000.

¹⁰ The definition of a "foreign customer" was repealed by Act 198 because the requirement that the contracting or services be performed "for a foreign customer located outside the State" was repealed.